THE WORLD ECONOMY BETWEEN THE WORLD WARS

Charles H. Feinstein
Peter Temin
Gianni Toniolo

OXFORD
UNIVERSITY PRESS
2008

weekly needs of households. However, the federal government was unhappy with the seemingly disappointing progress of the FERA schemes, and as a further unemployment crisis was looming in November 1933, a new agency was created—the Civil Works Administration (CWA)—for the immediate creation of four million jobs, leaving FERA to care only for unemployable people. A third agency, the Civilian Conservation Corps (CCC), was also created to set up work camps for young people and war veterans.

By January 1934, the CWA had been able to create the targeted four million new jobs in road creation and repair, public-building construction, and park construction. It was the largest and perhaps the most successful work-relief program in the depression. However, it was relatively expensive, and it created political difficulties with those unable to get the CWA's relatively well-paid jobs, so the program was terminated in the spring of 1934.

FERA took over again, and in 1935 the agency developed five new emergency-relief programs, two of which focused on educational content, one was directed to the so-called "interstate" transient who did not qualify for relief support in any state, and the remaining two focused on rural America.

As work-relief programs made little impact on the roots of unemployment, they may perhaps be better seen as steps in the development of the American welfare state. According to Fearon, "in February 1934, FERA, CWA, and CCC together gave aid to eight million households or some 22 per cent of the population" (1987, 243). But this form of emergency relief was not an appropriate permanent arrangement. In 1935, Congress passed the Social Security Act, one of the most important and long-lasting New Deal reform laws. The act provided for old-age pensions and unemployment compensation. These provisions were not to be seen as relief to destitute people but as a general insurance scheme paid for by taxes on both employers and employees.

Chapter 8

The Fragmented World of the 1930s

The two central themes in this chapter are the disintegration of the international economy that followed the onset of the depression and the more or less successful path to recovery in the main areas of the world. We look first at the extent of the disharmony and rivalry displayed by European nations and the United States at the World Economic Conference of 1933. Cooperation was desperately needed to mitigate the effects of the slump, but it was not forthcoming. Each country had its own agenda, its own economic and political priorities, and its own preferred solutions. The next sections examine the operation of the different trading areas that emerged in this decade, the economic policies followed by the main participants in each area, and their growth and employment outcomes.

Table 8.1 summarizes in a nutshell (with a good dose of oversimplification) the relation between exchange rate and domestic policies on the one hand and economic performance on the other, as measured by GDP per person. (This relation is discussed in more detail in the second part of the chapter.) By and large, recovery from the depression was faster and more robust in countries that, by an early dismissal of convertibility, were free to put in place fiscal and monetary polices apt to stimulate domestic aggregate demand.

England and the sterling area are the textbook case in point. By ending gold convertibility of the pound in September 1931, England was able to lower interest rates, thereby stimulating investment, particularly in the construction sector. The depreciation of the exchange rate stimulated both exports and the substitution of domestic products for foreign products. A somewhat muddled and inefficient way of getting rid of gold-standard constraints on domestic demand management without formally suspending convertibility (a move that some governments saw as a political suicide) was to introduce administrative controls on capital movements. For all practical purposes, this amounted to a devaluation of the currency. This policy was followed by Germany and later by Italy.

Table 8.1 Exchange-rate policies and paths to economic recovery in the 1930s (GDP per person; 1929 = 100)

	1929	1932	1935	1938
Early devaluation and domestic expansion				
United Kingdom	100.0	93.5	105.0	113.9
Sweden	100.0	94.8	109.4	122.1
Japan	100.0	96.8	104.6	120.8
Early devaluation, protection, and import substitution				
Brazil	100.0	89.5	101.1	112.2
Colombia	100.0	100.4	111.4	122.5
Controls on capital movements and domestic expansion				
Germany	100.0	83.0	101.7	123.3
Italy	100.0	95.3	101.8	107.2
Central planning and autarky				
Soviet Union	100.0	103.8	136.3	155.1
Late devaluation				
United States	100.0	71.1	77.5	87.0
Gold bloc (continuous deflation)				
France	100.0	84.0	86.8	94.8
Belgium	100.0	91.1	96.8	95.6
Switzerland	100.0	90.2	93.3	100.9
Overvalued peg to pound and deflation				
India	100.0	97.4	93.4	91.8

Source: GDP per person Maddison (2001, passim)

As shown in table 8.1 and discussed below, many variations of this pattern to recovery were possible, as illustrated for instance by the cases of Brazil and Japan. Recovery proved weak where devaluation came late, as in the case of the gold-bloc countries. As it turned out, each trading area or country followed its own policy as a second-best alternative to coordinated reflation. We begin therefore by reviewing the failed attempts at international cooperation that characterized the early 1930s.

8.1 Attempts at International Cooperation

U.S. President Herbert Hoover imposed a one-year moratorium on payments of reparations in July 1931, too late to avert the German crisis. In August, an international committee chaired by American banker Albert Wiggin could only urge world leaders to reestablish political confidence before the expiration of the moratorium, as the only condition for new international lending to Germany. In December 1931, a "Special Advisory Committee" at the Bank for International Settlements issued a report that recommended "the adjustment of all intergovernmental debts as the only lasting step to re-establish confidence," given the "unprecedented gravity of the crisis," which much exceeded "the relatively short depression envisaged in the Young Plan" (Toniolo, 2005, 129–30).

While the British government was leading an effort to convene a conference to discuss the recommendations of the Special Advisory Committee, German Chancellor Brüning stated in January 1932 that Germany would seek the complete cancellation of reparations. The French vehemently responded that they would not cede their right to reparations. The British and the Italians supported the Germans, leaving the French nearly isolated. The United States remained uninterested in reparations but adamantly opposed war-debt repudiation, thus forfeiting an opportunity to exercise leadership. Politics stood in the way of economic cooperation. As one observer put it: "If none of the governments could get its own way, at least they were able to block each other's path" (Bennett, 1962, 249).

Brüning's January 1932 statement and its repercussions in other capitals delayed the conference. Impending elections in France and Germany also contributed to the delay, as neither government would be in a position to make concessions prior to elections. The delay in convening the meeting contributed to the collapse of Chancellor Brüning's government.

The Lausanne Conference on Reparations

The Lausanne Conference finally opened in June 1932, with the French opposing substantial concessions, and the Italians, British, and Germans favoring a clean slate. The proceedings at Lausanne were complicated by a disarmament conference concurrently meeting in Geneva, where the United States informed England and France that it would not allow European default on war debts while funds sufficient to cover the payments were being used for armament spending. The British and the French favored a clause linking reparations with an American war debt settlement. Germany objected to the American argument, asserting that there was no link between the two obligations and that an agreement had to be definite and independent of America.

Eventually, a Lausanne Convention was signed that put an official end to reparations. As a face-saving measure for the French, Germany was required to deposit bonds worth 3 billion marks (£125 million) with the Bank for International Settlements. The bonds were to be floated by the bank after three years, if Germany was judged to be capable of paying. As it turned out, the

bonds, never issued, were burned in 1948. Germany was thus permanently relieved of reparations obligations.

The 1933 World Economic Conference

An annex of the Lausanne Convention called for a world economic conference to address the major remaining international economic issues. The British Treasury had favored such a conference since late 1930. France had blocked England's attempts to coordinate an international conference in 1931, fearing pressures to join in an artificial international redistribution of gold and German manipulation of the conference to obtain a reparations reprieve. After the sterling devaluation of September 1931 removed British pressure for gold redistribution, and after the Lausanne Conference of June 1932 ended German reparations, both these obstacles to cooperation had been eliminated.

The Lausanne Conference had also spelled the end of wartime inter-Allied debts, but the issue formally remained open. The French and British asked President Hoover to postpone the December 1932 war-debt payment, but he refused. France and several other European nations simply did not pay their 1932 and 1933 installments. Great Britain paid by earmarking gold in the Bank of England, angering American public opinion and increasing President-elect Roosevelt's determination to keep war debts off the agenda for the World Economic Conference. As for reparations, war debts remained an internationally divisive issue, even when it had long become obvious that they would not be honored in the future. Too late, the United States officially recognized the situation by passing legislation in 1934 that put officially an end to wartime inter-Allied debts. Again, lack of effective leadership made cooperation impossible on the eve of the 1933 economic conference.

As the London conference approached, prospects for success grew ever dimmer. As the value of the dollar fell during May 1933, Roosevelt—freshly inaugurated as President—became less interested in exchange-rate stabilization, reversing the cooperative policies he had advocated. Meanwhile, the French government conveyed to the United States and British governments its belief that exchange stabilization (by which they meant a reintroduction of gold convertibility) was a prerequisite for success in London.

Central bank representatives from Britain, France, and the United States decided in June 1933 that exchange stabilization was possible. Each agreed to buy and sell gold to keep their currencies within prescribed limits of 3 percent either way. The provisions of the stabilization were to be kept secret, and the agreement was to be null if the details were made public. Declarations were prepared stating that the three governments intended to limit fluctuations of the dollar and sterling for the length of the conference, that stabilization on gold was the ultimate objective, and that they would avoid measures that might interfere with monetary stability.

Unfortunately, the news of dollar stabilization leaked to the press, and American markets responded quickly. The dollar strengthened, and commodity and stock prices fell as investors anticipated a return to deflation. Roosevelt telegraphed his negotiators in London to reject the agreement, insisting that he did not wish to restrict his domestic-policy options and that he was not certain at what level the dollar belonged. After attempts to sway the President failed, Roosevelt's rejection was announced at the conference, causing turmoil and intensifying speculation against the Dutch florin and the Swiss franc, but restoring the recovery of American markets.

After the collapse of this agreement, the French concentrated pressure on the British to stabilize and join the gold-standard countries, warning of impending monetary anarchy in Europe. In response, the British asked for a currency declaration, which was quickly drafted and approved by the gold countries. To the consternation of the French, however, the British invited American participation in the agreement. The United States representative revised the document until the only remaining points were a call for monetary stability, recognition that an eventual return to the gold standard was desirable, and a statement that individual nations would take action to avoid speculation. He advised Roosevelt to accept the document, fearing that the United States would be held responsible for the collapse of the conference.

Roosevelt nonetheless sent a message to London on July 1 rejecting the declaration. His infamous bombshell exploded in the faces of the conference and the public two days later. The message, loaded with inflammatory rhetoric, accused the stabilization discussion of interfering with the real issues that the conference should address. In Roosevelt's words (Roosevelt, 1969, 269): "The world will not long be lulled by the specious fallacy of achieving a temporary and probably an artificial stability in foreign exchange on the part of a few large countries only . . . . The sound internal economic situation of a nation is a greater factor in its well-being than the price of its currency."

Roosevelt later admitted that the message was too heavy in rhetoric, but several economists agreed with his general argument; Keynes even said that Roosevelt was "magnificently right" (Feis, 1966, 238). Nonetheless, parts of the logic and rhetoric of Roosevelt's message were contorted. His concerns about a United States gold drain were offset by the fact that the country possessed one-third of the world's gold reserves. His qualms about only two or three nations stabilizing were contradicted by the fact that several countries were ready to stabilize in terms of the dollar, franc, and pound. The distinction he stressed between governments and central banks was essentially irrelevant in considering a stabilization agreement. His central message, however, was that he wanted to give priority to domestic reflation; given the circumstances, this was the only correct option he had.

The failure and collapse of the World Economic Conference is traditionally attributed to Roosevelt's message. But the conditions for international

economic cooperation were not present in mid-1933. By this time, each of the major countries was entrenched in the defense of its own economic and political interests, as perceived by domestic constituencies. Instead of seeking the necessary compromises to initiate international cooperation, each of the major industrial and financial powers would become the center of a currency and trading bloc of its own. Countries left out of such blocs, as many Latin American countries were, had to try to find domestic solutions, usually by retrenching into protectionism.

8.2 The Sterling Area

Britain's devaluation, however badly executed, allowed Britain to reduce interest rates and expand the economy. Devaluation improved the trade balance and, more important, freed macroeconomic policy from the "golden fetters" of the gold standard. Many of Britain's trading partners followed Albion's example. They too benefited from the relaxation of constraints on expansionary policy. While none of these countries reached full capacity in the 1930s, they grew faster and absorbed more unemployment than the countries that clung to the gold standard.

The pressure to give up the gold standard was especially great among relatively small countries with export-based economies for which the United Kingdom was the primary market. Denmark, Sweden, Norway, and Finland followed Britain off gold, but they did not immediately peg to sterling. By January 1932, Japan, Venezuela, and Bolivia were adopting policies that increasingly resembled basing on sterling. The countries that pegged to sterling between 1931 and 1933 formed the sterling area, composed of the colonial empire and India, semi-independent nations including Iraq and Egypt, the dominions excluding Canada, and other countries, particularly in Scandinavia.

The reasons for choosing to link with sterling varied among these groups. India and the colonial empire were compelled to do so by Britain; this was not unusual, as a sterling peg had previously been used to stabilize these currencies. Australia and New Zealand had already suffered exchange depreciation, and they needed to be tied to sterling to retain competitiveness in the British market. South Africa, after initially trying to maintain its gold parity, was forced to devalue and peg to sterling for similar reasons.

Many smaller European and Latin American countries chose to link to sterling because Britain was a primary export market, and because most of their reserves were denominated in sterling. The Brussels Conference of 1920 and the Genoa Conference of 1922 had encouraged holding foreign currency instead of gold, and unless these countries devalued and repegged to gold, they would suffer large capital losses on their sterling reserves.

Just as there were multiple reasons for pegging to sterling, there were multiple mechanisms for maintaining this new parity. The currency-board system implemented for the colonial empire, Egypt, and Iraq provided an automatic relationship with sterling. A system of semi-independence, in which the exchange rate was rigidly fixed and maintained through large sterling reserves, was maintained in India, Australia, New Zealand, South Africa, and Portugal. The third policy, an autonomous system of maintaining a target sterling parity without holding large sterling reserves, was attempted in Scandinavia.

The British government studiously avoided encouraging countries outside the colonial empire and India to devalue or to peg to sterling, but it supported nations that voluntarily committed to the sterling area. In December 1931, the Bank of England provided a credit of £500,000 to the Bank of Finland, which was trying to maintain sterling parity through exchange controls. In the same month, a credit of £250,000 was granted to Denmark. Throughout the 1930s, Australia received sizable standby credits that, while never used, demonstrated British willingness to stabilize exchange rates within the sterling area.

Soon after the devaluation of sterling in September 1931, British Treasury officials began to consider a monetary policy for the empire. Treasury officials shared the political leaders' opinion that prices were too low, but they feared that the empire countries might promote inflationary programs of deficit monetization, public works, and deliberate credit expansion that could potentially destabilize sterling. In early 1932, the discussion of empire monetary policy developed into preparations for a British Commonwealth conference to be held in Ottawa.

Trade and the 1932 Commonwealth Conference in Ottawa

At the 1932 Ottawa meeting, monetary policy issues were confined to a committee through which the British advanced their policies, reassuring the dominions and India that monetary policy would be directed toward higher prices and recovery, but avoiding discussion of stabilization. The principal discussions at Ottawa were devoted to trade agreements. In February 1932, the United Kingdom had finally deserted its long-standing commitment to free trade. The government introduced the Import Duties Act, providing for an immediate 10 percent import duty on all goods except basic foodstuffs, raw materials, and goods already subject to duty. It also established an Import Duties Advisory Committee with power to recommend higher duties for specific goods, and the nominal tariff on most manufactures was quickly raised to 20 percent.

The United Kingdom delegates had hoped to obtain improved entry for British manufactures in the Commonwealth markets, but Australia, Canada, and the other dominions were unwilling to take any measures that would harm their emerging manufacturing industries. However, it was agreed that the dominions would give preferential access to British producers by raising higher tariffs against imports of manufactures from non-Commonwealth countries,

and Britain would in turn grant Commonwealth producers preferential access to the British market for food and raw materials.

The policies adopted at the Ottawa Conference helped to bring about a considerable shift in the pattern of United Kingdom trade, with a marked increase in the importance of purchases from and sales to the dominions. The broad picture can be seen in table 8.2. The share of United Kingdom imports purchased from the four dominions increased dramatically from 13 percent in 1929 to 23 percent in 1938, and there was also a rise in the proportion acquired from India and from Britain's colonies in Africa. In Europe, only the Scandinavian countries and Portugal were able to maintain their share of the United Kingdom market.

Table 8.2 Changes in the direction of United Kingdom trade, 1929 and 1938 (percentages)

	UK Imports		UK Exports	
	1929	1938	1929	1938
British Commonwealth and sterling area				
Dominions[a]	13.0	23.1	19.6	25.4
Ireland	4.0	2.5	4.9	4.3
India, Burma, and Ceylon	5.5	7.4	11.5	8.5
Other British Commonwealth	6.4	9.3	10.0	14.1
Total Commonwealth	28.9	42.3	46.0	52.3
Scandinavian countries and Portugal	10.1	10.5	5.3	9.4
Total	39.0	52.8	51.3	61.7
Rest of the world				
Gold bloc[b]	14.1	9.6	11.5	9.5
Exchange-control group[c]	8.2	5.4	8.1	6.5
Other Europe	4.2	3.3	3.2	3.2
	26.5	18.3	22.8	19.2
United States	16.6	12.8	6.2	4.4
Argentina	7.2	4.2	4.0	4.1
Other Latin America	3.6	4.8	4.5	2.5
Other countries	7.1	7.1	11.2	8.1
Total	61.0	47.2	48.7	38.3
Total	100.0	100.0	100.0	100.0

[a] Australia, Canada, New Zealand, and South Africa.
[b] Belgium, France, Netherlands, Poland, and Switzerland.
[c] Austria, Czechoslovakia, Germany, Hungary, and Italy.

Source: League of Nations (1939), 285, 307.

The rest of the world, including the United States, the gold-bloc countries, the exchange-control group associated with Germany, and Argentina all lost ground. The share in British trade of the countries outside the empire and sterling area fell from 61 percent in 1929 to 47 percent in 1938. Since the actual value of United Kingdom imports in the later year was still well below the 1929 level, this meant a large absolute fall in the amounts sold to Britain by these countries.

On the export side, there was a very similar story. The share of the much-reduced United Kingdom exports sold to the four dominions rose from 20 percent to 25 percent, and the proportion taken by the colonies and by the Scandinavian countries also increased. The striking exception to this general trend within the Commonwealth and sterling area was the fall in British sales to India, where competition from both Japan and domestic producers continued to hit British textile exports. Despite this, the share of United Kingdom exports to the Commonwealth and sterling area countries increased from 51 percent in 1929 to 62 percent in 1938.

Cheap Money and the Sterling Area

When the World Economic Conference ground to a halt following Roosevelt's attack on attempts to stabilize currencies, the formation of the gold bloc led by France, with its intent to deflate world prices, caused alarm among the primary producing nations of the sterling area; they feared that the British might join the gold bloc. The Chancellor of the Exchequer's response was to reaffirm his commitment to cheap money and higher prices, but also to express concern that Europe, which eventually must abandon gold, should not fall apart in chaos during the conference. The British Commonwealth Declaration was signed on July 27, 1933, resolving to raise prices, ease credit and money except for monetizing government deficits, and keep exchange rates stable within the sterling area. It also added a perfunctory commitment to eventually restore the gold standard. The declaration succeeded in quieting talk of further depreciation in the empire, distracting attention from the general failure of the World Economic Conference, and reaffirming the usefulness of the Ottawa agreements.

As the dollar became more unstable and the United States did little to encourage pegging to the dollar, this declaration formalizing the sterling area made it a more attractive option for countries seeking to stabilize their exchange rates. Denmark, Sweden, and Argentina formalized their sterling pegs soon after the British Commonwealth Declaration. Norway had officially pegged to sterling in May 1933, having devalued 9.5 percent from the sterling gold parity rate.

From late in 1933 to 1938, the sterling-to-dollar exchange rate was reasonably stable, meaning that a large part of the world enjoyed five years of

exchange-rate stability. Following devaluation of the franc in September 1936, France tried to maintain a fixed sterling rate, much as the Scandinavian countries had done from 1931 through 1933. Greece and Turkey also devalued slightly and linked to sterling, and Latvia moved from a franc peg to a sterling peg, with a substantial devaluation.

The cheap-credit policies of Britain allowed the sterling system to accommodate the cheap-money policies of Scandinavia, Australia, South Africa, and other devaluing nations. London facilitated the operation of the system by supplying sterling-area nations with the sterling reserves they needed. The stability of the pound throughout the decade encouraged a willingness to hold sterling balances, and the combination of increased production in South Africa and dis-hoarding in India supplied gold to the sterling area, ensuring convertibility.

While British policy could not create the international cooperation necessary to initiate worldwide recovery, most nations in the sterling area performed better in the 1930s than members of other trading and currency arrangements. Adherence to the gold standard had spread the depression; relaxing the harsh discipline of this rigid system was the first step to recovery. In fact, Great Britain and most of the countries that devalued in 1931 enjoyed a fairly rapid economic recovery and were able to absorb a good part of the depression unemployment. Once freed from the gold-standard commitment, the British government could lower interest rates to revive domestic demand, particularly in the construction industry, while the devaluation of the currency both stimulated exports and provided some protection from foreign competition. After 1932, such a protection, and the attendant import substitution in manufacturing, was granted by the tariff; at the same time, a slight revaluation of the pound and its subsequent stabilization allowed for competitive import of raw material.

India within the Sterling Area

India was an important exception to the relatively rapid sterling-area recovery from the Great Depression. The Indian position within the payment system of the British Empire had always been a peculiar one, as it entailed pegging the traditionally silver-based rupee to the gold-based pound sterling. In 1893, the silver standard had been replaced by a gold-exchange standard, but silver coins continued to make up the bulk of circulation (Rothermund, 1996, 88–90). At the beginning of the century, the rupee was pegged to the pound at an exchange rate of 1s 4d (15 rupees per pound). After the war, the Indian government maintained such a deflationary policy that in 1927 legislation was passed to fix the exchange rate to the pound at 1s 6d (a 12 percent appreciation over the already overvalued British currency). This parity was defended in 1927–1931 by way of deflationary monetary policies. These were carried out

by melting down silver coins without proportionally increasing paper circulation (Mukherji, 2005, 369).

When the pound was taken off gold, the government of India hoped to be able to seize the opportunity for an adjustment of the pound-rupee exchange rate. George Schuster, the finance minister in the Viceroy's government, proposed to unlink the rupee from the pound and let it float so it could find its own market price. But London thought otherwise, and even Montague Norman, the Governor of the Bank of England and a patron of Schuster, found the proposal unpalatable. The rupee remained pegged to the pound at the 1927 rate of 1s 4d.

With the devaluation of the pound sterling, the price of gold in terms of pounds (and of the pegged rupee) increased. "A large part of the hoarded gold in India, including household possessions of gold in rural India, started to flow out of the country, a process that came to be known as 'distress sale' of gold," Mukherji notes (2005, 369). Together with the continuation of monetary deflation, the outflow of gold facilitated the maintenance of the exchange rate of the rupee, in spite of the large interest payments India had to make on its considerable foreign debt (almost entirely owed to London). The rupee often traded above its statutory (pegged) value.

A tight monetary policy (the bank rate was 7 percent until July 1932 and 4 percent thereafter) was coupled with cuts in government expenditure. In particular, little was done to reduce unemployment by way of public works, while expenditure on public health, education, and irrigation was curtailed.

With its overvalued currency, India did not benefit from the Ottawa agreements and the British recovery as did other Commonwealth countries that were allowed to devalue with the pound. If imperial preferences somewhat lessened the competition from non-Empire countries, the latter acquired an edge on the Indian market. Moreover, Indian traders complained about the way the country had been treated in setting up the Imperial preference scheme. These complaints, however justified, highlight a rising discontent among the Indian trading middle class. Such discontent, compounded with the general distress and the hardship in the countryside, had a lasting political impact, so that a number of historians see the "decolonization process" as beginning with the Great Depression.

India's per capita GDP stagnated throughout the 1930s, falling by 6 percent between 1929 and 1939 (Maddison, 2001). The value of India's exports per capita fell by about 40 percent between 1929 and 1950, as compared to a 13 percent decline in total world exports. India, therefore, turns out to be a peculiar case within the sterling trading area, which elsewhere managed to lessen the impact of the depression and hasten recovery by an early currency devaluation accompanied by easy money and domestic-market protection within the system of imperial preferences. The Indian case once more stands out as a confirmation of one of the main tenets of this

book: misguided macroeconomic demand management stood in the way of economic prosperity.

Latin America: Almost in the Sterling Area

After an initial orthodox deflationary response to the shock of 1929–1930, Latin American countries discovered in 1931 that "it was possible to abandon gold standard rules and did so with alacrity" (Thorpe, 1998, 111). Defaults on foreign debt rapidly followed, as currency depreciations made payments on both principal and interest unbearable at a time of falling export revenues. With few exceptions, Argentina being the most noticeable one, by 1934 most Latin American countries had defaulted. Devaluation and default (which markets took surprisingly lightly) allowed room for expansionary fiscal policies. Recovery came in many cases quite rapidly when these hitherto open economies took a more inward-looking policy stance. Import quotas and tariffs were introduced in Brazil and Chile, while some countries began to support the export sector (the Brazilian government, for instance, brought large quantities of coffee to sustain its price, going as far as burning coffee instead of coal in train locomotives). Argentina, traditionally linked to the British financial and product markets, remained relatively open to the sterling area, under the Roca Runciman Treaty of 1933, which gave the United Kingdom important tariff concessions. Recovery from the depression turned out to be slow.

After the initial moment of respite and recovery, several governments increasingly stepped up their intervention in the economy, mainly to promote import substitution and supply diversification. The government of Getulio Vargas in Brazil was particularly active in promoting a large spectrum of growth-enhancing and inward-looking policies. Other Latin American governments (e.g., Colombia's) engaged in expansionary fiscal policies, but in most countries, circumstances dictated more radical reforms: increased wage flexibility, land reform, price regulation, public works, and improved financial structures (Heim, 1998, 45). It has therefore been argued that the increasing isolation of the subcontinent turned out to be a blessing in disguise. Declining export revenue (due both to falling prices and the emergence of a protectionist "center") and the drying up of foreign lending forced policy makers to experiment with new economic policies to promote industrialization (Diaz Alejandro, 1984; Heim, 1998).

The results of these policies were quite remarkable. By 1932, Brazil and Colombia had already recovered their 1929 GDP level, even before exports had begun to recover (Thorpe, 1998, 113–14). With export recovery under way from 1933, Argentina and Mexico also sped up growth, recovering pre-depression income levels by 1934 and 1935 respectively. In every case, manufacturing output grew faster than GDP, as import substitution and diminished dependence on a small number of export staples stimulated domestic supply.

Manufacturing growth rates ranged from 3 percent per annum in Argentina to more than 8 percent in Colombia.

8.3 The Gold Bloc

Continental Europe (excluding Scandinavia) stayed with gold, although they did so in two very different ways. The gold bloc led by France stayed on the gold standard, preserving open currency exchanges at pre-Depression currency values. The Nazi area, led by Germany, elaborated the currency controls it had instituted in 1931, formally preserving the value of the mark while abandoning any of the theoretical benefits of the gold standard and enjoying freedom in monetary and fiscal policy.

The gold bloc of the 1930s included most countries of the Latin Monetary Union of 1865, which—under French leadership—created an area of free currency circulation comprising France, Italy, Belgium, French, and Switzerland (with other countries joining later). Before 1914, the currencies of all these countries traded at equal parities, all being modelled on Napoleon's *franc germinal*. After 1914, parities could not be maintained, and in the 1920s, each currency stabilized, and gold convertibility was reintroduced at different parities.

In response to Roosevelt's message to the World Economic Conference and the turmoil that emerged in its aftermath, the representatives of France, Belgium, Holland, Switzerland, Italy, and Poland released a joint declaration stating that their governments would strive to maintain the gold standard and the stability of their currencies at their current parities, both to create a stable gold platform for the recovery of international exchange-market stability and to promote social progress at home. Representatives of their central banks met in Paris, and on July 8 they pledged to support each other's currencies, settling each other's claims in gold-convertible currencies or gold.

While the gold bloc was to develop a reputation for possessing little cohesion and no organization, its initial declaration successfully ended the speculation against the Dutch florin and the Swiss franc that had persisted during the proceedings of the World Economic Conference. Despite this strong beginning, however, the gold bloc remained a symbolic organization. No progress was made in developing the connections among the central banks or the government policies of the gold bloc nations after the July 8 meeting.

Of all the trading blocs that emerged in the aftermath of the London Economic Conference, the gold bloc was the only one still constrained to follow the stringent deflationary policies demanded by the gold standard. The continuing efforts in these countries to hold their economies to this harsh course made recovery from the depression of the early 1930s particularly slow. Unemployment stayed relatively high, as described in section 7.2.

This misguided ideological purity was one of the factors that stood in the way of international cooperation.

Within the constraints of the existing gold parities, countries had only two options to protect their trade balances: exchange controls and deflation. Among the central European nations, including the emerging trading bloc around Germany, tariffs were supplemented by exchange controls, nominally leaving the countries on the gold standard but effectively rendering the system meaningless. In contrast, most countries in the gold bloc regarded exchange controls as incompatible with the workings of the gold standard and against the spirit of the system. Continued deflation was the only available policy, therefore, and the core gold-bloc countries sustained this policy for as long as they could.

The French had been successful in the early years of the decade in keeping their current-account deficit small through trade barriers, but by 1933 the situation was steadily growing worse. The decline in economic activity was accompanied by lower government revenues, resulting in budgetary deficits that caused great alarm among the French populace, who still bore the memory of the inflationary cycles of the mid-1920s. The political effects of expenditure cuts and new taxes created a situation of turmoil in which there were four governments in 1932, three in 1933, and four in 1934. Even though the decline in prices left the real wages of pensioners, veterans, and government employees higher than their original levels, attempts to reduce fiscal expenditures by reducing payments to these groups were highly unpopular.

Within the gold bloc, the high prices resulting from the overvalued gold-standard parities of the currencies discouraged trading among the bloc's members. French trade with Belgium decreased 13 percent between 1933 and 1934, and French trade with Switzerland decreased by 40 percent. To encourage trade among themselves, the gold-bloc nations met in Geneva in September 1934 and signified their agreement to increase trade and tourism within the bloc and to arrange another conference to meet in Brussels in October to discuss trade policy. Poland was not allowed to participate in either the Geneva or the Brussels conferences, ostensibly because its economy was structured differently from those of the other members of the gold bloc, but more likely because the other members were reluctant to include a nation whose economy was in as desperate need of assistance as Poland's was in 1934.

The conference opened with the Italian and Dutch delegations expressing reluctance to reaffirm their countries' commitment to maintain the gold standard and their currency parities. Under French guidance, the conference was brought to a close with an agreement for gold-bloc countries to continue bilateral negotiations to allow for a ten percent increase in gold-bloc trade by June 30, 1935. The conference therefore was successful to the extent that the gold bloc survived intact. But the results of the proposed negotiations were not the least bit encouraging for gold-bloc unity. The French agreed in principle to increase Belgian trade, but the proposed 10 percent increase was unattainable.

Belgium had been severely hurt by its loss of competitiveness in British markets with the sterling devaluation in 1931. In September 1934, the Belgian government asked for more French assistance, but neither loan arrangements nor proposals to lower French quotas on Belgian goods were enacted. In March 1935 the British government limited steel imports, worsening Belgium's plight. In desperation, the Belgian government reopened talks with France to seek economic assistance. Again, the French could not offer more than token assistance. Returning from Paris essentially empty-handed, the Belgian government was forced to impose exchange controls. A new government devalued the Belgian franc on March 30, repegging it 28 percent lower, at a level calculated to restore the prices of Belgian goods to the levels of British and American prices.

When the gold bloc was officially declared in the aftermath of the World Economic Conference, French opinion was firmly opposed to devaluation of the franc as an alternative to deflation. Memories of the inflation and currency crises of the early 1920s were still an extremely powerful force. However, as the disparity between the recovery of countries with depreciated currencies and the stagnation of gold-bloc countries became apparent, individuals within French political and journalistic circles began to support devaluation, although public opinion remained strongly opposed. The primary danger to the franc was perceived to be the budget deficits that threatened to resurrect the debt monetization and the resulting inflationary cycles that had caused the economic chaos of the 1920s. Fearing these consequences, successive French governments struggled with programs to reduce expenditure and augment decreasing revenues, but economic contraction and budget deficits persisted.

The Popular Front, a coalition of the Radical, Communist and Socialist parties led by Léon Blum, took office in June 1936 with a plan to restore economic growth with a French New Deal. Blum renounced deflationary policies, but he did not devalue. France consequently suffered serious depletion of its gold reserves. The Popular Front introduced a shortened work week of forty hours without a reduction in wages, and the government raised wages to stimulate consumption and ignite the economy. The Matignon Accords, which forced employers to sign a package of wage increases, were the Popular Front's solution to widespread labor unrest.

By mid-1936, there was widespread support for devaluation among politicians, publicists, and banking and financial experts, but still not among the general populace. The government's opposition to devaluation during 1934 and 1935 had so effectively convinced the French public that devaluation would cause a return of inflation that this opinion persisted among the populace through 1936, initially precluding a unilateral devaluation. Ultimately, however, it proved impossible to withstand the pressure against the franc; this

final episode in the disintegration of the interwar gold standard is taken up in section 9.4.

Clinging to the gold standard, France and the other remaining members of the gold bloc were helpless to alleviate the depression in their countries. The professed cure for disequilibrium was the persistent source of the disease. When they could no longer maintain this stance, they had to choose between currency controls like the Germans or devaluation like the UK and United States. Abhorring the former, they chose the latter.

8.4 The Nazi Trading Area

Germany's Currency Controls

After the banking and currency crises of July 1931, the German government allowed banks to reopen only after freezing foreign deposits and limiting foreign-exchange transactions to the Reichsbank. In the summer of 1931, therefore, Germany abandoned the gold standard for all practical purposes by imposing controls on foreign-exchange transactions, but did not devalue the mark. The initial exchange controls were strengthened in September, following the sterling devaluation, by more efficient measures. These required owners of gold and foreign assets to sell them to the Reichsbank, restricted the amount of foreign exchange available to importers, and compelled exporters to surrender their foreign-exchange proceeds to the Reichsbank. Behind the shelter of controls on capital movements, an expansionary monetary policy was introduced in the summer of 1932 and was beginning to have a positive impact on output and employment by January 1933, when Adolf Hitler and the Nazi party came to power.

As described in section 6.5, the Nazi government inherited from the Weimar Republic a set of policies including exchange control, work-creation projects, government intervention in banking, and the program for agriculture. The Nazis also continued to formally maintain the gold value of the mark, under the protection of administrative controls on conversion. Germany had always had a high degree of government involvement in the economy and in foreign-trade policy. The Nazis added terror to the government's toolkit for enforcing compliance with economic controls, including exchange and trade controls.

The deterioration of world trade in the 1930s was magnified in Germany by the devaluations of sterling and the dollar, relative to gold and the mark, by the rise of protectionism, and by capital flight resulting from Jews fleeing persecution and from domestic and foreign responses to Nazi policies (see section 9.1). In the short term, the government's responses in 1934 were increased foreign-exchange restrictions and a moratorium on interest payments on debt to foreigners. A long-term strategy was contained in the "New Plan" of Hjalmar Schacht, the president of the Reichsbank and the minister of finance,

which encouraged autarky by restricting imports and provided commodity boards to create greater administrative control of trade. In 1935, a scheme was initiated to extend subsidies to German exports that were not competitive on world markets because of the overvalued mark. These inward-looking policies proved to be quite effective in promoting the expansion of domestic output. Between 1932 and 1938, Germany's real GDP per person grew at a most respectable rate of 6.6 percent per year.

The trade policies of the Nazis, moving toward autarky, initially were directed to increase consumption and reduce unemployment, but later policies focused on rearmament and preparing for a war economy after a shortage of foreign exchange convinced the Nazis they could not afford both guns and butter. German goals included military preparedness and administrative control over the domestic population, with politics taking precedence over economics. The price paid for this was fewer available import goods and increased labor intensiveness.

The Nazis initiated bilateral trade agreements that took several forms during the decade. One of the first systems was the private-compensation procedure, which created agencies that attempted to balance imports and exports by matching private exporters and importers to ensure offsetting trade. One characteristic of this system was the use of blocked marks, frozen funds held by foreigners and used at a discount to buy German exports. Through the use of blocked marks, German exporters could obtain higher prices in terms of marks for their products, and foreign importers purchasing these marks at a discount could purchase German exports at a lower price in terms of the foreign currency. Because this system was highly profitable for German exporters, its use was limited to additional exports, those goods that were not competitive in foreign markets due to the overvalued mark.

A second, more flexible method was the bilateral-exchange clearing system, which attempted to balance credits and debits on a national level. The mechanism of this system was conducted through clearing accounts in the Reichsbank. German importers paid marks to the Reichsbank account of the trading partner, where the funds were held until they could be used to pay German exporters for goods sold to the other country. If the accounts held insufficient funds, the exporters had to wait for imports to increase, and if there were excess funds, importers had to wait for increased exports. The central bank of the trading partner held similar clearing accounts for its exporters and importers. After the initial agreement with Hungary, Germany made arrangements of this type with Estonia, Latvia, Bulgaria, Greece, Yugoslavia, Romania, Czechoslovakia, and Turkey. While the details of each arrangement were different, all of these clearing agreements shared the common goal of opening trade controls to help export industries.

Germany's trade with Western Europe, traditionally an area of export surpluses, was limited by the decline in international trade and the rise

of exchange controls. Germany negotiated Sondermark Agreements with France, Belgium, the Netherlands, Switzerland, Italy, the Scandinavian countries, Spain, and Portugal to preserve these valuable export markets. These Sondermark Agreements involved partial rather than full clearing systems, with the establishment of clearing accounts for additional trade. Normal levels of trade were conducted according to foreign-exchange quotas, and the special accounts for additional trade, the trade that developed beyond normal levels, operated in the same manner as the bilateral-exchange clearing agreements between Germany and southeast Europe.

In 1934, the Auslander Sonderkonten fur Inlandszahlung (ASKI) procedure was introduced, replacing the private-compensation procedure, which had been less restrictive and had been used to avoid strict exchange controls. The ASKI procedure established accounts at German banks where foreign exporters' proceeds were held. Foreign exporters needed to secure permission from German exchange-control authorities to trade with Germany, with German imports limited to only those deemed necessary by the commodity-control boards. ASKI balances could be used to purchase certain nonessential German goods, but the goods had to be shipped to the country of the account holder. Two types of ASKI accounts developed: accounts for individual foreign exporters, and accounts for foreign commercial banks that represented a group of foreign traders.

The New Plan also created a system of payment agreements with Great Britain, Belgium-Luxembourg, Canada, France, and New Zealand. These agreements provided for the release of free foreign exchange to pay for imports and to transfer payment on old German debts. In addition, Germany agreed to import goods equal to a specified fraction of its exports to each country. The effect of the New Plan was to extend and develop the exchange controls of the early 1930s, replacing the ineffective ones with more stringent controls.

The exchange-control system in place after the New Plan consisted of three different arrangements: the stringent ASKI agreements, the more moderate clearing agreements, and the more lax payments agreements. Germany's free trade was limited to only a small group of countries, including the United States, because the overvalued mark doomed Germany to a trade deficit where trading agreements were not in effect.

The Reorientation of Germany's Trade

Germany's bilateral trading agreements accounted for 50 percent of Germany's trade by 1938. German trade with southeast Europe often is overemphasized, as the Balkans bought only seven percent of Germany's exports in 1935 and 11 percent by 1938. While these parts of Europe were regarded as prime areas for German economic and trade expansion, there was significant resistance to any kind of limiting relationships with Germany. Germany incurred trade

deficits with most of her Balkan neighbours during the 1930s, and the largest German trade was conducted with western Europe, Latin America, and the Middle East.

Kitson (1992) concludes that Germany sacrificed terms-of-trade advantages that could have been won from its position as monopolist in export markets and monopsonist in import markets. Other objectives replaced improvements in the terms of trade, as isolation from the world market, reduced dependence on imports, and reorientation of trade to safe, adjacent countries took precedence. According to Neal (1979, 392) it was relatively costless, and often politically rewarding, for Germany to forgo the advantages of monopoly exploitation.

While England, France, the Netherlands, Belgium, Japan, and Italy increased trade within their empires—not always with satisfactory impacts on their domestic economies—Germany, which had no empire, was forced to develop a currency bloc, altering its pattern of trade. The pattern of changes between 1929 and 1938 is shown in table 8.3.

German trade was reoriented in favour of southern and eastern Europe, the countries with which it conducted the stricter policies of ASKI and clearing agreements. As trade between Germany and southeastern Europe increased, these nations became more dependent on exports to Germany's market for basic foodstuffs and raw materials. These countries were isolated in the post-Depression trade world, and Germany, paying prices 20 percent to 40 percent

Table 8.3 Changes in the direction of Germany's trade, 1929 and 1938 (percentages)

	German Imports		German Exports	
	1929	1938	1929	1938
Europe				
Southern and eastern Europe[a]	9.8	18.7	11.2	20.8
Scandinavian countries	7.4	11.3	10.2	12.9
Austria[b]	1.5	—	3.3	—
Gold bloc and Czechoslovakia	23.6	16.1	35.2	26.0
United Kingdom	6.4	5.2	9.7	6.7
	48.7	51.3	69.6	66.4
Rest of the world				
British dominions and colonies	12.5	10.3	4.3	6.1
United States	13.3	7.4	7.4	2.8
Latin America	12.1	16.8	7.8	12.1
Other countries	13.4	14.2	10.9	12.6
Total	100.0	100.0	100.0	100.0

[a] Bulgaria, Greece, Hungary, Italy, Romania, Spain, Turkey, and Yugoslavia.
[b] Not shown separately after unification with Germany in 1938.
Source: League of Nations (1939), 278, 300.

above the world level for agricultural commodities, was the most attractive market. A trading bloc was effectively established, providing Germany with a dependable source of necessary commodities.

Between 1929 and 1938, Germany's exports to southeastern Europe, Spain, and Italy rose sharply from 11 percent to 21 percent of total exports, and the proportion of Germany's imports from this region increased from 10 percent to 19 percent. There was also an increase in the share of German trade with the Scandinavian countries, especially Sweden, and with Latin America. By contrast, Germany's trade with the gold-bloc countries, Czechoslovakia, and the United Kingdom became relatively less important as these countries turned to other sources and markets, especially within their own empires.

Although successful in reorienting German trade, the Nazi policies never made southeastern Europe one of Germany's major trading partners, and some of the increase that did occur was simply the reestablishment of older trading patterns that had been disrupted by the inflations and upheavals of the 1920s (for details, see Aldcroft, 2006).

Italy between Germany and the Gold Bloc

The Italian case is somewhat peculiar in that, while a member of the gold bloc, it followed a trade pattern and a path to economic recovery that increasingly resembled that of Germany.

With the floating of the pound in 1931, the lira—having previously stabilized at a high rate—turned out to be overvalued with respect not only to sterling but to the other gold-bloc currencies as well. Mussolini tried once again, as in 1927, to curb wages and salaries by decree, in order to compensate for the revaluation of the currency. This time, however, the policy was less successful: real wages remained stable between 1929 and 1932 and rose thereafter. Controls on capital movements (foreign-exchange controls, in the language of the 1930s) were therefore introduced, at first surreptitiously then in a most open fashion, in order to stem the outflow of gold reserves. Italy needed its gold reserves if it wanted to stay in the gold bloc, an important objective for Mussolini, who placed pride in the stability and strength of the lira. In July 1935, to stem speculation during the African campaign, the Italian government prohibited gold exports. Together with controls on capital movements came clearing agreements. After a moment of political tension with Germany in 1934–1935, Italy reoriented its trade toward its northern neighbour, happy to enter into clearing deals. Trade with the colonies, never of major importance, was carried out within the currency area of the lira. Argentina, a traditional trading partner, signed clearing agreements with Italy, as did several European countries, including Great Britain. The lira, like the mark, remained on gold only formally, thank to a panoply of exchange controls, tariffs, quotas, and clearings.

Economic recovery came in early 1935 with Mussolini's decision to invade Abyssinia. Deficit spending on armaments produced a sharp increase both in total employment and in the number of hours worked in manufacturing. Sanctions imposed by the League of Nations (which incidentally drew many opposition members on Mussolini's side) prompted the launch of an autarky (import substitution) program that brought Italy closer to the trading area of Germany.

Japan as a Different Mixed Case

Japan—the third member of the future Axis—also created its own trading area, which expanded with the Japanese military expansion. Externally, Japanese economic policies were like those of the sterling area, based on devaluing the currency and gaining the possibility of expansive domestic policies. Internally, Japan was more like Germany and Italy in emphasizing military expenditures and expansion.

In the 1920s, successive Japanese governments committed to a return to gold at a relatively high parity. But easy money and government spending were called for in the wake of the Kanto earthquake of 1923 and after a major spree of bank failures in 1927. Deflation was postponed to allow for whatever monetary expansion was needed to provide lending of last resort (Faini and Toniolo, 1992). From a macroeconomic viewpoint, the tragedies of the 1920s were a blessing in disguise, as the administration of the bitter medicine of deflation was repeatedly postponed, to the advantage of output and employment growth. It was only in 1929 that the Hamaguchi cabinet produced an austerity fiscal budget leading to the reintroduction of the gold standard, at the prewar parity, in January 1930 (Metzler, 2006) .

If this was not the appropriate moment for a return to convertibility, Japan was quite swift in redressing the policy mistake. One of the first moves of a new cabinet that took power in December 1931, with Takahashi as minister of finance, was to again suspend gold convertibility, in January 1932. Only two years after its ill-timed reinstatement, the Japanese gold standard was buried for good. Left to float, the yen depreciated by 60 percent in 1932.

As in the case of Germany and Italy, recovery came from military expenditure. The Japanese depression turned out to be mild and short-lived. By September 1931, the armed forces had acquired a prominent political role in Japan, and the country began military operations in Manchuria. By early 1932, the region was entirely occupied by Japanese forces. This acquisition of new territory enlarged the overseas Japanese Empire, which already included Korea and Taiwan. The empire's boundaries coincided with the inner circle of the yen trade area, where international commerce was organized along the lines of similar areas (such as the British and German areas), which featured a manufacturing center and a less developed primary-producing periphery.

Japan succeeded in riding out the world depression remarkably well. The devaluation of the yen stimulated exports, while domestic demand for military purposes resulted in an impressive industrial growth. That growth, however, increased the dual character of the economy, composed of rapidly expanding heavy industry and mining concerns (the Zaibatsu) on the one hand, and low-wage consumer industry and agriculture on the other. The 1930s were not free from social tensions, and militarism became ever more pervasive and aggressive. In 1937, a new military campaign in China brought large parts of that country under Japanese control.

8.5 The United States and Russia as Polar Opposites

America and the Soviet Union, future allies in the Second World War, pursued diametrically opposite policies in the 1930s. They both achieved economic growth, if at very different speeds, but the United States did it by opening up the economy, while Russia closed its economy even more than Germany did. The Soviet Union did not experience a depression, and its GDP per person grew by 6.6 percent per annum between 1932 and 1938. Over the same period of time, the growth rate in the USA was 3.5 percent, and output in 1938 was still below the 1929 level. Russia and the United States were at very different stages of economic growth as the depression began, and some differences may have come from the enormous potential for catch-up existing in the backward Soviet economy. Much more of the discrepancy came from ideology.

President Roosevelt took office at the beginning of March 1933, about a month after Hitler became chancellor of Germany. To some, the two new leaders looked indistinguishable: "new men" who would rescue the world from the grip of the Great Depression. The two men were very different, of course, and it is a historical curiosity that it took some people several years to figure this out. Roosevelt set out to preserve democracy in the United States, while Hitler moved quickly to destroy it in Germany. Germany ended up fighting both the United States and Russia in the Second World War, and one of the reasons Germany and its cobelligerents lost was the robust economic growth of the United States and Russia in the 1930s (Overy, 1996). They achieved their growth by implementing very different policies, to which we now turn.

The New Deal in the United States

As Roosevelt took office at the start of March 1933, he was greeted by a massive run on American banks that was produced in part by his reluctance to proclaim his adherence to the gold standard during the long gap between his election in November 1932 and his inauguration. He responded to the bank runs by proclaiming a "bank holiday" and closing *all* banks in the United States. This holiday represented the final collapse of the American financial system. The new president gathered a diverse group of advisers around him, and he seems to have adopted all their suggestions as he tried to put the economy back together again. In a flurry of activity he proposed myriad bills to Congress in the next three months that are known collectively as the New Deal.

The first strand was macroeconomic in modern terms. Roosevelt abandoned the gold standard in April 1933 in the context of agricultural reform. He appointed a new head of the Federal Reserve System who would allow the money stock to expand as gold flowed into the United States. He supported banking reform, from the clean-up required to end the bank holiday to the separation of commercial and investment banking in the Glass-Steagall Act. This act also mandated the formation of the Federal Deposit Insurance Corporation, which was designed to avoid future bank runs by insuring the bank deposits of ordinary people. It took effect only after recovery had begun and bank runs were no longer an issue, but it has prevented the recurrence of bank runs in postwar recessions.

A second strand was agricultural reform. The Agriculture Adjustment Act (AAA) allowed the government to control the production of agricultural commodities. By restricting production, policy makers hoped to increase agricultural prices. Devaluation also increased prices, most notably in wheat, which was traded on an international market. The dollar price of wheat jumped 30 percent when the dollar was devalued (Temin and Wigmore, 1990). The program's overall goal was to raise agricultural prices to a level that would provide the same purchasing power in 1933 that they had provided before the war, in 1914. The prewar conditions were adopted as "parity," against which all current arrangements were judged.

Industrial reform followed the model of agricultural reform. The National Industrial Recovery Act (NIRA) provided incentives for employers and employees to negotiate agreements on hours of work, wages, and other working conditions. If these agreements were in accord with codes drawn up by the government, they were exempt from antitrust laws. In fact, the government did not challenge any agreements; it delegated authority to industry groups. The resultant contracts shortened working hours in an attempt to spread the work over more people. At the same time, in an unprecedented act in the middle of a depression, the agreements raised wages. Employers agreed to this increase in their costs if they in turn were allowed to raise prices.

As with agriculture, the intent of the NIRA was to raise prices in order to restore confidence in the economy and implement Roosevelt's famous dictum: "The only thing we have to fear is fear itself." The NIRA succeeded in these aims, and both prices and production rose rapidly in the later 1930s. A sharp recession in 1937 interrupted this progress, and unemployment remained high, as described in Chapter 7, throughout the decade.

The Reciprocal Trade Agreements Act of 1934 also reformed United States tariff policy. Gone was the previous pattern of omnibus trade bills with abundant scope for logrolling and high rates. In its place was a plan to negotiate foreign trade agreements that would not require direct congressional approval. Although the original bill was passed amid fierce partisan dissent, the change in trade policy turned out to be permanent (Irwin and Kroszner, 1999).

There are many explanations for why the recovery in the United States was not rapid enough or continuous enough to eliminate its massive unemployment. One explanation is that the many reforms sometimes got in the way of each other. The increase in prices engineered by the AAA and the NIRA served to absorb much of the increase in the money stock that resulted from capital inflows. Another explanation is that high wages continued even after the NIRA was declared unconstitutional in 1935, discouraging employment of more workers. Yet another reason may be that the unemployment at the nadir of the depression was so large that even a rapid increase in production was not enough to eliminate it quickly.

Collectivization in the Soviet Union

Once the Soviet revolution had finally succeeded in the civil war against the "white" armies, the Soviet Union set about developing its economy in almost extreme isolation from the rest of the world. One of the features of the post-1914 "globalization backlash" was the subtraction from world trade of the enormous wealth in agriculture and natural resources contained in the former Russian Empire. Counting precisely on that wealth, Stalin set out to overcome Russia's economic and technical backwardness by building "socialism in one country." The concept was a powerful one. "Bolshevism was combined with nationalism, and the destiny of the revolution was left in the hands of Russia" (Berend, 2006, 146).

The state took upon itself the task of modernizing and developing the economy. Once firmly in power, in 1927–1928 Stalin started a major industrialization drive. After long preparation, in 1929 the first Five-Year Plan was launched, which set the overambitious goal of more than doubling industrial output by 1932. Ever since the reign of Peter the Great, Russia had been accustomed to major development drives, often followed by depression brought about by economic and social exhaustion. But even in Russia, nothing had ever been attempted on such a gigantic scale and with such brutal, ruthless use of the state's monopoly on violence. Stalin's "second revolution" spread terror throughout the country. Economic growth became the only idol, to which everything else had to be sacrificed.

Peasants made particularly good fodder for the economic god. When the Bolsheviks found that they could not get grain from Russian farmers in the late 1920s, chiefly because the farmers had nothing to buy with their earnings, the

Bolsheviks collectivized Russian agriculture. Farmers were extremely unhappy about this change, particularly the "kulaks," prosperous farmers whose lives were at risk as the grain shortages were blamed on them. Farmers responded to government coercion by slaughtering and eating their farm animals, which meant there were no animals to work the land in the early 1930s. Massive famine was the result, in which as many as five million people may have died. The famine obviously did not accelerate economic growth; instead it facilitated government control over the peasants (Allen, 2003).

Forced transfer of labor and capital from agriculture to manufacturing and from consumer-goods production to investment-goods production, accomplished through carefully executed (if wasteful) central planning, tremendously accelerated the transformation of the Soviet Union from an agrarian economy to an industrial economy. The statistical debate over measurement of Russia's GDP growth in the 1930s is still unresolved, but recent studies (e.g., Allen, 2005) leave little doubt of its astonishing speed. While in 1929–1939 the whole world was more or less successfully struggling to find ways out of the depression, the product per person of the Soviet Union increased by about 61 percent, experiencing only a very minor setback in 1932.

Surprisingly, foreign trade also increased considerably, again against the prevailing world trend. If, between 1914 and 1929, Russia's exports declined by almost 5 percent per annum, in 1929–1959 they experienced a handsome annual growth rate of more than 3 percent, compared to a virtual stagnation of total world trade and the negative growth rate that characterized western European export trade. In fact, the Soviet Union increased both its output and its exports faster than any of the other trading areas.

The Third International could thus tout the astonishing success of socialism against the visible failure of capitalism to deliver recovery, let alone growth and full employment. Few outside the Soviet Union knew of the purges, concentration camps, and police brutality within its borders, which explains why "the world admired what happened there" (Berend, 2006, 150).